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NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION THREE

YOSHINOYA WEST, INC., Plaintiff and Appellant, v. FRANCHISE TAX BOARD, Defendant and Respondent.	B178751 (Los Angeles County Super. Ct. No. BC274343)

APPEAL from a judgment of the Superior Court of Los Angeles County, Richard C. Hubbell, Judge. Affirmed.

Rodriguez, Horii & Choi, Dwayne M. Horii, William C. Choi, Hilary C. Kingston; Benedon & Serlin, Gerald M. Serlin and Douglas G. Benedon for Plaintiff and Appellant.

Bill Lockyer, Attorney General, W. Dean Freeman and Donald R. Currier, Deputy Attorneys General, for Defendant and Respondent.

Plaintiff and appellant Yoshinoya West, Inc. (Y-West) appeals a judgment in favor of defendant and respondent State of California Franchise Tax Board (FTB or the Board) in an action by Y-West for refund of franchise taxes paid.

The essential issue presented is whether the trial court properly concluded Y-West failed to meet its burden of showing the Board was incorrect in its determination that Y-West engaged in a unitary business with its parent company, Yoshinoya D&C Co., Ltd. (Y-Japan) during the taxable years ending December 31, 1986 and December 31, 1987.

We conclude the trial court's decision was correct and affirm the judgment.

FACTUAL AND PROCEDURAL BACKGROUND

Y-West is a wholly owned subsidiary of Y-Japan. Y-West is a Delaware corporation headquartered in Torrance, California, and operates fast food takeout restaurants under the name "Beef Bowl" in Southern California.

a. *Evidence relating to Y-West's relationship to Y-Japan.*[1]

Y-Japan is a Japanese corporation headquartered in Tokyo, Japan. Y-Japan operates a large chain of quick service restaurants in Japan that specialize in its signature dish, the Yoshinoya Beef Bowl. Until the mid-1970's Y-Japan had no restaurants outside of Japan.

In 1977, Y-West was incorporated by Yoshinoya America, Inc. (Y-America), a wholly owned subsidiary of Y-Japan. While parent to Y-West, Y-America provided Y-West with a no-interest loan, the balance of which was $3,951,670 as of December 20, 1985.

In 1983, Y-Japan appointed Takeshi Kojima (Kojima) as President and Chief Executive Officer of Y-West and named him as one of Y-West's two directors. Simultaneously, Kojima was elected to Y-Japan's board of directors and appointed as

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[1] The facts in this section are drawn from the trial court's statement of decision, which the trial court derived from the parties' joint stipulations. Y-West does not challenge any of these factual findings on appeal.

general manager of Y-Japan's overseas operations division. Kojima served as a director and president/CEO of Y-West from 1983 to 1989. During the first half of 1986, the other Y-West director was Osamu Shibuya, who was also chairman of the board of directors of Y-Japan. During the second half of 1986 and all of 1987, the other Y-West director was Jun Sugimoto, who served concurrently as chairman of Y-Japan's board of directors.

During 1986 and 1987, Y-West's vice president and director of store operations was also a member of Y-Japan's overseas operations division. Y-West's general manager from 1978 through 1988 is currently the director of Y-Japan's international department in Japan.

During 1986 and 1987, several of the officers and high-level management at Y-West were current or former Y-Japan directors, officers or management employees. All Y-West policy and day-to-day operational decisions were made or approved by Kojima, a member of Y-Japan's board of directors and Y-Japan's general manager of overseas operations.

During 1986 and 1987, numerous Y-Japan employees were transferred at Y-Japan's expense to Y-West. Many of the transferred employees were Y-Japan store managers, but others were executive or corporate management personnel. All of the decisions regarding the transfer of Y-Japan employees to Y-West were made by Y-Japan's human resource manager.

Y-Japan and Y-West executives regularly communicated with each other and Y-West executives made several trips to Japan during 1986 and 1987.

Y-West submitted regular reports to Y-Japan detailing sales and net income by store, number of employees and breakdowns of sales by food category.

In 1987, Y-Japan expanded its operations in Taiwan via a joint venture with Taiwan Yoshinoya Co., Ltd. (Y-Taiwan). In September 1987, Y-West invested in Y-Taiwan by purchasing three percent of its stock. This interest was later sold to Y-Japan at Y-West's cost.

b. *The Board assesses Y-West additional taxes for the years 1986 and 1987 on the ground it was a unitary business with Y-Japan.*

In 1999, the Board issued notices of proposed action for the tax years ending December 31, 1986 and December 31, 1987, proposing the assessment of additional taxes against Y-West on the ground it was a unitary business with Y-Japan. Y-West appealed the proposed assessments to the State Board of Equalization, denying that it was part of a unitary business. The Board of Equalization denied relief. On January 11, 2001, Y-West paid the assessed deficiencies, together with accrued interest, for a total of $1,731,534.

c. *Trial court proceedings.*

On May 22, 2002, Y-West filed suit in the superior court for refund of the $1,731,534 tax payment, alleging it was not engaged in a unitary business with Y-Japan and that it was entitled to calculate its California franchise taxes on a separate accounting basis for the years 1986 and 1987.

The dispute between Y-West and the Board is legal, not factual. As noted by Y-West in its trial briefs, the underlying facts are undisputed. The parties entered into a joint stipulation of background facts, as well as a supplemental joint stipulation. The stipulated facts as well as joint exhibits were submitted to the trial court, and the matter was submitted on previously filed legal briefs and oral argument.

d. *Trial court's ruling.*

On October 15, 2004, the trial court issued a statement of decision, which states in relevant part: "Here, unity of ownership is not contested. Nevertheless, [Y-West] contends that it did not engage in a unitary business with [Y-Japan] because: (1) [Y-West] and [Y-Japan] had dissimilar operations; (2) [Y-West] and [Y-Japan] were managed independently; (3) [Y-West] and [Y-Japan] had different suppliers, service providers, and operational departments; (4) [Y-West] and [Y-Japan] made independent day-to-day and major policy decisions; (5) in contrast to its relationship with [Y-West], [Y-Japan] was actively involved in the operations of its other businesses. Thus, plaintiff asserts that, although unity of ownership exists, unity of operation and unity of use do

not. Plaintiff also contends that [Y-West's] business is not dependent upon and does not contribute to the business of [Y-Japan] and that [Y-West] and [Y-Japan] were not functionally integrated, thus resulting in no economies of scale.

"The court finds that [Y-West] has not satisfied its burden of proving that the FTB's determination is incorrect. Although [Y-West] was not managed independently by Mr. Kojima, he served two roles – President of [Y-West] and Director of Overseas Operations for [Y-Japan]. When coupled with the evidence of personnel transfers and the evidence that [Y-West] and [Y-Japan] were engaged in the same general line of business, the court concludes that plaintiff's evidence fails to overcome the determination of the FTB that [Y-West] engaged in a unitary business with [Y-Japan].

"As [Y-West] has not satisfied its burden of proving that it was not engaged in a unitary business with [Y-Japan] and has not met its burden under the law to prove that it is entitled to a refund of franchise taxes paid for the years ending December 31, 1986 and December 31, 1987, the Court finds in favor of defendant Franchise Tax Board."

Y-West filed a timely notice of appeal from the judgment.

CONTENTIONS

Y-West contends: it is entitled to a de novo review by this court of its purported unitary relationship with Y-Japan; the trial court also was required to exercise its independent judgment and determine the issue de novo, rather than deferring to the Board's determination; Y-Japan and Y-West were not engaged in a unitary business, so as to preclude California from combining the income of the two entities in calculating the tax due; there is no unity under the applicable case law; Y-Japan and Y-West are not unitary under the "same general line of business" presumption of California Code of Regulations, title 18, section 25120, subdivision (b)(1); and the factors relied on by the trial court do not rise to the level of unitary significance.

DISCUSSION

1. *General principles.*

a. *Taxation of unitary businesses.*

With certain exceptions, California imposes a franchise tax on "every corporation doing business within the limits of this state . . . ." (Rev. & Tax Code, § 23151 (a).)[2] A unitary business is one that receives income from or attributable to sources both within and without the state. (§ 25101; *Citicorp North America, Inc. v. Franchise Tax Bd.* (2000) 83 Cal.App.4th 1403, 1411.) If a unitary business exists, taxes are apportioned by formula to allocate to California for taxation, " 'its fair share of the taxable values of the taxpayer . . . .' [Citation.] In calculating corporate franchise taxes of a unitary business, the FTB apportions income generated by the unitary business based on the relationship of the combined income to the income derived from California sources." (*Id.* at p. 1411.)

b. *Definition of "unitary business."*

A unitary business "is generally defined as two or more business entities that are commonly owned and integrated in a way that transfers value among the affiliated entities. In *Butler Brothers v. McColgan* (1941) 17 Cal.2d 664, 668 [111 P.2d 334], our Supreme Court stated that the presence of the following three factors is sufficient to establish the existence of a unitary business: (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in its centralized executive force and general system of operation. In *Edison California Stores v. McColgan* (1947) 30 Cal.2d 472 [183 P.2d 16], the court proposed an alternative standard that stated if the operation of the portion of the business within the state is dependent upon or contributes to the operation of the business outside the state, its operations are unitary. (See also *Container Corp. v. Franchise Tax*

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[2] All further statutory references are to the Revenue and Taxation Code, unless otherwise indicated.

Bd. (1983) 463 U.S. 159, 179 [103 S.Ct. 2933, 2947-2948, 77 L.Ed.2d 545] [noting three elements of a unitary business: (1) functional integration; (2) centralized management; and (3) economies of scale].)" (*Citicorp North America, Inc. v. Franchise Tax Bd., supra*, 83 Cal.App.4th at p. 1411, fn. 5.)

2. *Burden of proof and standards of trial court and appellate review.*

a. *Y-West had the burden to establish its entitlement to a refund; the trial court was required to make a de novo determination as to whether Y-West met its burden.*

"In a suit for tax refund, the taxpayer has the burden of proof; he must affirmatively establish the right to a refund of the taxes by a preponderance of the evidence. [Citations.]" (*Consolidated Accessories Corp. v. Franchise Tax Board* (1984) 161 Cal.App.3d 1036, 1039.) Thus, at trial it was Y-West's burden, as the taxpayer, to prove entitlement to the claimed refund by establishing by a preponderance of the evidence that it was not engaged in a unitary business with Y-Japan.

The trial court's role was to apply statutory, regulatory and case law and to determine de novo whether Y-West met its burden to prove its entitlement to a refund. (*Tenneco West, Inc. v. Franchise Tax Bd.* (1991) 234 Cal.App.3d 1510, 1520.)

b. *Standard of appellate review; we review questions of law de novo.*

Insofar as there are any disputed issues of fact, we review the trial court's factual findings under the substantial evidence standard. (*Tenneco West, Inc. v. Franchise Tax Bd., supra,* 234 Cal.App.3d at p. 1521.)

However, we utilize the independent review standard where, as here, taxing statutes are applied to undisputed facts. "This issue was addressed in *Anaconda Co. v. Franchise Tax Board* (1982) 130 Cal.App.3d 15 [181 Cal.Rptr. 640]: 'Extensive testimony and voluminous documentary exhibits were received in evidence, but the essential facts of the case are undisputed. Since the issues here involve the application of taxing statutes to uncontradicted facts, this court is confronted purely with a question of law and is not bound by the findings of the trial court. [Citations.]' [Citations.]" (*Brown Group Retail, Inc. v. Franchise Tax Bd.* (1996) 44 Cal.App.4th 823, 829; accord,

Tenneco West, Inc. v. Franchise Tax Bd., supra, 234 Cal.App.3d at p. 1520 ["[o]n those matters where the decisive facts were undisputed, we are confronted with questions of law and not bound by the trial court's findings"].)

c. *No merit to Y-West's contention the trial court improperly deferred to the Board's determination.*

Y-West contends the trial court used an improper standard of review and erred in deferring to the Board's determination. The argument is unsupported by the record.

The trial court, in its statement of decision, noted " 'In a suit for tax refund, the taxpayer has the burden of proof; he must affirmatively establish the right to a refund of the taxes by a preponderance of the evidence.' [Citation.] Thus [Y-West] has the burden of proving that it did not engage in a unitary business with [Y-Japan]." This pronouncement by the trial court is a correct statement of the law. (*Consolidated Accessories Corp. v. Franchise Tax Board[, supra,]* 161 Cal.App.3d [at p.] 1039.)

Y-West's contention confuses the standard of review with the burden of proof in a refund action. As explained, Y-West bore the burden in the trial court to establish its entitlement to a refund. Merely because the trial court assigned the burden of proof to Y-West does not mean the trial court failed to determine *de novo* whether Y-West met its burden. (*Tenneco West, Inc. v. Franchise Tax Bd., supra,* 234 Cal.App.3d at p. 1520.)

Moreover, even assuming the trial court was under a misapprehension as to its standard of review, "the trial court's misperception of its standard of review does not require reversal here." (*Tenneco West, Inc. v. Franchise Tax Bd., supra,* 234 Cal.App.3d at p. 1520.) As noted by Y-West in its trial briefs, the underlying facts were undisputed. On those matters where the decisive facts are undisputed, we are confronted with pure questions of law and are not bound by the trial court's determination. (*Ibid.*) Based upon the stipulated facts and facts as found by the trial court, we determine "whether as a matter of law application of unitary treatment is appropriate." (*Id.* at p. 1521.) Therefore, the trial court's standard of review is not significant at this juncture.

We now turn to the merits of the appeal.

3. *Y-West and Y-Japan are unitary under the dependency or contribution test.*

a. *Overview.*

As indicated, "Courts have generally used two tests to determine whether related business entities are engaged in a unitary business. The first is known as the '*three unities test*.' Under this test, unity exists where there is (1) unity of ownership; (2) unity of operation evidenced by central purchasing, management, accounting and the like; and (3) unity of use in the centralized executive force and general system of operations. [Citations.] [¶] The second widely accepted test is the '*dependency or contribution*' test. Under this more general test, a business is unitary if ' . . . there is evidence to indicate that the segments under consideration are . . . dependent upon or contribute to each other and the operations of the taxpayer as a whole.' [Citations.] Either test is constitutionally permissible. [Citation.]" (*A. M. Castle & Co. v. Franchise Tax Bd.* (1995) 36 Cal.App.4th 1794, 1803-1804, italics added.) The two tests are *alternative* methods to determine unity. (*Id.* at p. 1805.)

Our focus here is on the dependency or contribution test. As explained below, we conclude Y-West and Y-Japan are unitary under the dependency or contribution test and therefore we need not address the three unities test.

b. *The criteria required to establish a presumption of unity.*

When a corporation "invests in a business which is truly 'distinct' from its main line of business, the investment serves the primary function of diversifying the corporate business and reducing risks inherent in business cycles. Such a diverse business is less likely to be unitary with its parent. However, when a corporation invests in a subsidiary which is engaged in the same 'line of work' as itself, it becomes much more likely that one function of the investment is to make better use of the parent's existing resources. In these circumstances, the two businesses are likely to be unitary. [Citations.]" (*A. M. Castle & Co. v. Franchise Tax Bd., supra,* 36 Cal.App.4th at pp. 1807-1808.)

The Board has adopted this principle in its regulations, specifically, California Code of Regulations, title 18, section 25120 subdivision (b)(1).[3] (*A. M. Castle & Co. v. Franchise Tax Bd., supra,* 36 Cal.App.4th at pp. 1807-1808.) Said regulation provides in relevant part: "In general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole. The following factors are considered to be good indicia of a single trade [or] business, and *the presence of any of these factors creates a strong presumption that the activities of the taxpayer constitute a single trade [or] business*: [¶] (1) Same type of business: A taxpayer is generally engaged in a single trade or business *when all of its activities are in the same general line*. For example, a taxpayer which operates a chain of retail grocery stores will almost always be engaged in a single trade or business." (Cal. Code Regs., tit. 18, § 25120, subd. (b)(1), italics added.)[4]

In interpreting this regulation, *A. M. Castle & Co.* explained, "two corporations are engaged in the same 'general line' of business when: (1) the two businesses are *similar* (but not necessarily identical); and (2) after the two corporations are combined, it permits the parent corporation to make better use of its existing business related resources. This may be done through 'economies of scale,' 'operational integration,' *or 'sharing of expertise.'* [Citations.]" (*A. M. Castle & Co. v. Franchise Tax Bd., supra,* 36 Cal.App.4th at pp. 1808-1809, italics added.)

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3 All references to "regulation section" shall refer to the corresponding section of the California Code of Regulations, title 18, unless otherwise indicated.

4 " '[A] regulation adopted by a state administrative agency pursuant to a delegation of rulemaking authority by the Legislature has the force and effect of a statute. [Citations.]' [Citation.]" (*Tyler v. Children's Home Society* (1994) 29 Cal.App.4th 511, 539.) Revenue and Taxation Code section 19503 authorizes the FTB to "prescribe all rules and regulations necessary for the enforcement of . . . Part 11 (commencing with Section 23001)." Therefore, regulation section 25120, which helps implement the corporation franchise tax, has the force of law.

c. *The evidence establishes Y-West and Y-Japan were unitary during the tax years at issue.*

(1) *Y-West and Y-Japan were in the same general line of business.*

The trial court, in its statement of decision, found Y-Japan and Y-West "operate within the same general line of business within the meaning of [regulation section] 25120(b)(1).)" Based on the uncontroverted facts, we agree.

Y-Japan and Y-West operated restaurants that specialized in similar products, namely, bowls of steamed rice topped with sliced meat. However, Y-West argues the restaurant operations were dissimilar due to menu variations, in that its "basic menu items reflected American tastes." For example, unlike Y-Japan, which offered only a beef bowl, Y-West also offered a teriyaki chicken bowl and a combination bowl. Also, Y-West used leaner beef than Y-Japan (70/30 meat to fat ratio instead of 50/50 ratio).

These menu variations which accommodated the taste of consumers in different markets do not support the contention that Y-Japan and Y-West were in different lines of business. There is no requirement that the two businesses be identical; it is sufficient if they are similar. (*A. M. Castle & Co. v. Franchise Tax Bd., supra,* 36 Cal.App.4th at p. 1808.) Here, both entities operated fast food restaurants that offered a limited menu of rice bowls. We conclude, as the trial court did, that Y-Japan and Y-West were in the same general line of business.

(2) *The two entities being engaged in the same line of business, Y-West enabled Y-Japan to utilize its management expertise in expanding its fast food operation in the United States.*

Y-West was incorporated in 1977 to conduct California fast food restaurant operations and opened its first restaurant in 1979. The members of Y-West's board of directors were also board members of Y-Japan, and key officers and other personnel were systematically transferred between the two entities. Consequently, Y-West enjoyed the benefit of an experienced management team, while Y-Japan gained operational

experience for its international expansion.

(a) *100 percent of Y-West's board members simultaneously served as board members of Y-Japan.*

During 1986 and 1987, Y-West had a two-member board of directors, one of whom was Kojima, who served concurrently as a member of Y-Japan's board. The other director of Y-West (first Osamu Shibuya and then Jun Sugimoto) was the chairman of Y-Japan's board of directors. Thus during the years at issue, both of Y-West's directors, or 100 percent, served concurrently as directors of Y-Japan.

Y-West characterizes these circumstances as a "limited crossover" of directors and a "small number of interlocking . . . directors." The fact remains that Y-West's entire board sat concurrently on the board of Y-Japan.

(b) *100 percent of Y-West's officers concurrently were active executives in Y-Japan's overseas operations division.*

During 1986 and 1987, Y-West had two officers: Kojima, who served as its president; and Akira Terashima (Terashima), who served as vice president of store operations. During this time period, Kojima and Terashima concurrently served as officers or executives with Y-Japan's overseas operations division.[5]

Here again, Y-West characterizes these circumstances as a "limited crossover" of officers between the two companies and a "small number of interlocking officers." The fact remains that *all* of Y-West's officers concurrently served as executives with Y-Japan.

(c) *Other key personnel systematically were transferred between Y-Japan and Y-West.*

During the years in issue, Y-West employed 21 Japanese nationals who previously had been employed by Y-Japan. Employees were transferred to Y-West from Y-Japan "for the purpose of allowing them the opportunity to obtain experience in American style

restaurant operations and management." Y-Japan reimbursed Y-West for costs advanced by Y-West for the benefit of Y-Japan employees, "including United States moving costs incurred by Japanese nationals transferring from [Y-Japan] to [Y-West.]"

Y-West minimizes these circumstances, asserting "[its] employment of former Y-Japan employees as low level store management employees is of little unitary note. The small number of persons transferred from Y-Japan relative to [Y-West's] total number of employees substantially reduces any unitary significance to the transfers. Because the Japanese workers had to be retrained completely for work in [Y-West] operations (in light of the substantial differences in Y-Japan's and [Y-West's] operations and management), there was no 'flow of value' or 'economy of scale' inuring to [Y-West] from the transfer."

These arguments are unpersuasive. The contention that the transferees were "low level" and had to be "completely retrained" for work in Y-West's operations is unsupported by the joint stipulations.

Moreover, as the Board points out, Y-West's contentions raise the question why Y-Japan would (1) transfer low level store employees rather than hire them locally, (2) pay their relocation expenses from Japan to the United States, and (3) incur the expense to "completely retrain" those employees, if the transfers did not generate a flow of value to the Y-Japan unitary enterprise, so as to make the transfers worthwhile. A more reasonable inference to be drawn from these facts is that both entities benefited from the transfers. Y-West was able to utilize existing management expertise, while Y-Japan gained international experience in furtherance of its overseas expansion.

Y-West's reliance on *F. W. Woolworth Co. v. Taxation & Revenue Dept.* (1982) 458 U.S. 354 [73 L.Ed.2d 819], which held Woolworth and four foreign subsidiaries were *not* a unitary business, is misplaced. There, "[w]ith one possible exception, [fn. omitted] none of the subsidiaries' officers during the year in question was a current or

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5 The only members of Y-Japan's overseas operations department were Kojima and Terashima.

former employee of the parent." (*Id.* at p. 366.) Further, with respect to managerial links, there were only "some." (*Id.* at p. 368.) "Woolworth maintained one or several common directors with some of the subsidiaries." (*Id.* at p. 368.) Here, as noted, during the tax years in issue, 100 percent of Y-West's officers concurrently served as executives with Y-Japan, and 100 percent of Y-West's directors concurrently sat on the board of Y-Japan.

We conclude the business conducted by Y-West in California depended upon and contributed to the business conducted outside of California by Y-Japan, making the two entities a unitary business during the tax years in issue. Therefore, the trial court properly entered judgment for the Board in Y-West's suit for a refund.

DISPOSITION

The judgment is affirmed. The Board shall recover its costs on appeal.

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

KLEIN, P.J.

We concur:

CROSKEY, J.

KITCHING, J.